

Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

NO PROTEST RECEIVED  
Release copies to District

Date: 8/26/99

Surname: [REDACTED]

Contact Person: ID [REDACTED]

Telephone Number: [REDACTED]

In Reference to: OP:E:EO:T:1

Date: JUN 15 1999

Employer Identification Number: [REDACTED]  
Key District Office: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated under the laws of [REDACTED]  
on [REDACTED] specifically to:

1. Provide a forum for collaborative strategic planning and service delivery activities for members of the corporation and other providers of health care services in order to improve the delivery, coordination, quality, appropriateness and efficiency of health care services provided to the residents of [REDACTED] and elsewhere.
2. Arrange for the provision of comprehensive, quality, cost effective health care services through a coordinated system of delivery, utilization review and quality assurance.
3. Educate health care providers and consumers about managed care and health promotion.
4. Enter into and participate in third party payor arrangements pursuant to which the corporation's members will offer their services as health care providers to organizations for which the corporation contracts for the delivery of health care services.

[REDACTED] your Articles of Incorporation provides that the number of individuals constituting the Board of Directors shall be five (5).

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██████████ Bylaws provides for members. Section ██████ provides that the corporation shall have one class of members. Section ██████ provides that each member of the active medical staff of ██████ who meets the requirements of Article ██████ shall be eligible to become a member of the corporation. Also, if the Board determines that participation in the corporation by one or more physicians who are not members of the active medical staff is required to enable the company to provide a full range of cost effective services and that the participation of such individual(s) in the corporation will further its business purposes, the Board, by affirmative vote of a majority of all the Directors in office, may invite such individual to apply for membership. Further, each member of the consulting or courtesy medical staff of the Hospital who has been invited by the corporation shall be eligible to become a member. All applicants for membership shall submit satisfactory credentials, pay the initial fee and meet certain other requirements. Such additional requirements include: (a) The execution of a Participating Provider Agreement with the corporation; (b) Participation in all of the third party payor arrangements for the delivery of health care services established, sponsored or approved by the corporation; and (c) The individual and any partnership or corporation of which he or she is a partner or employee must be willing to: (i) participate in and accept the result of the utilization review and quality assurance programs of the corporation, (ii) accept as payment in full for all services rendered the schedule of payment for professional services agreed to by the corporation and the Program, and (iii) provide coverage for all members of Programs.

██████████ Bylaws provides for the Board of Directors. The Board of Directors shall be comprised of 5 individuals and shall include a Medical Director, if one is appointed, 3 primary care physicians (those that specialize in internal medicine, family practice, or pediatrics) and 2 physicians who do not practice in a primary care specialty. Only members of the corporation shall be eligible for election as Directors, and any Director may be re-elected to multiple, successive terms.

██████████ Bylaws provides for committees such as a Nominating Committee and a Selective Contracting Committee. The Nominating Committee shall be comprised of the President and two (2) members and shall recommend nominees for the annual election of Directors. The Selective Contracting Committee shall consist of at least two (2) persons. It shall (a) review, evaluate and negotiate contracting options presented to it by the Board with HMOs, PPOs, insurers, employers, and other third party payors (such entities referred to as "Programs"); (b) report to

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the Board whether participation in particular Programs is recommended; (c) develop criteria for contract evaluation and offer general guidance to any agent appointed by the corporation to negotiate contract arrangements which may involve members; (d) explore and promote risk-sharing arrangements between the corporation and Programs; (e) develop and propose to the Board, for adoption, utilization review and quality assurance standards and other policies.

[REDACTED] Bylaws provides for a conflicts of interest policy. However, it is not as comprehensive as required by the Service. You have indicated that you are willing to adopt a more comprehensive policy.

[REDACTED] Bylaws provides for dues, fees, assessments and fiscal authority.

[REDACTED] Bylaws provides for dissolution. It states, in part that no member shall be entitled to receive an amount from a dissolution greater than the member's total contribution through dues, fees and assessments. In your letter dated [REDACTED] you state that it has never been your intention to have contributions refunded to members at some point in the future. You state that you are willing to amend your Bylaws.

You state that your sources of support are initial membership fees and yearly dues. Currently, annual dues are \$[REDACTED]. Capital contributions are set each year. You state that you are evaluated annually to determine the funding needed. In the past, a capital contribution has been needed to fund your requirements. In the current year, the \$[REDACTED] dues are the only fees being assessed.

In the financial information submitted for your [REDACTED] tax year you entered \$[REDACTED] as a disbursement to or for the benefit of members as PHO dues. However, in your letter dated [REDACTED], you state that such expenses are not for PHO dues. They are for staffing, operational expenses such as participation in contract discussions, educational opportunities, and other services such as the occupational health program.

With respect to the facilities out of which you conduct business, you state in your [REDACTED] letter that many of your functions are handled by your physician officers and such officers work from their practice site.

[REDACTED] (PHO) is a for-profit corporation. You own [REDACTED] % of the stock of PHO. PHO has two shareholders. You

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[REDACTED]

are one of the shareholders and [REDACTED] (Hospital) is the other shareholder. Your members nominate seven physicians to participate on the PHO Board on an annual basis. The Hospital also nominates seven members for the Board of the PHO. The physicians are not employed by PHO. PHO has a paid medical director who is not one of your members. You state you are a vehicle for the physicians to be organized and provide guidance to your members to participate in PHO. You state that you secure the third party contracts and PHO provides the physicians who offer their services as providers. You state that there are no formal contractual agreements between you and [REDACTED].

PHO also has a contract with a local physician that provides medical support for the occupational health program.

Your members are the active medical staff of [REDACTED], members of the consulting or courtesy medical staff of the Hospital, or any other physician the Board determines will further your exempt purpose. You presently have [REDACTED] members, none of which are hospitals, corporations or associations. You state that the benefits you offer members are clinical and operational educational offerings; voice and participation in PHO issues surrounding community wellness, employer concerns, and their practice; and participation in PHO contracts.

In your letter dated [REDACTED], you state that the officers of the Board and the members of the Board of Directors are member physicians. These physicians provide healthcare services to participants for which the PHO has contracts. These individuals are compensated based on a fee schedule which is agreed upon by the third party payor. The fee schedules are determined by using a [REDACTED] model. A fee schedule is received from a third party payor and in turn you forward this schedule to your member physicians. This [REDACTED] process allows the physicians to respond on an individual and/or group basis as to whether they wish to participate in that particular fee schedule.

Regarding your activities, you state that you provide for [REDACTED] (PHO) contracting and education services for your members. Members must participate in third party payor arrangements (managed care contracts) as negotiated for the delivery of health care services to the local community. They must also participate in utilization reviews and quality assurance programs.

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You state that you provide a way for physicians to stay organized and educated in order to maintain current clients in the most efficient and effective manner. You also state that education includes, but is not limited to, keeping physicians apprised of Medicare/Medicaid rules and procedures. You further state that it is a way for the physicians to be able to negotiate with the local hospital with a unified voice.

You state that you have participated in the formation of an occupational health program for community employees (██████████). In your letter dated ██████████ you state that this program is sponsored by PHO. Thus, you state, you were essential to provide the vehicle for a comprehensive occupational health program. You submitted ██████████ as a description of the program.

██████████ states that ██████████ is an occupational health program established to provide integrated communication and patient tracking, to assist in facilitating timely patient care, return to work and modified duty programs. The ██████████ staff keep communication open between the injured employee, the treating physician, the employer and the insurance company. ██████████ coordinates treatment recommendations for the physician, obtains authorization from the payor, collects treatment and progress documentation and forwards to payer to ensure timely payment, provides treatment plan and expected date of return to work for employer, and coordinates team conferences as needed.

██████████ contracts with employers to provide services for them, including case management, per-employment, post-accident or random urine drug screens, breath alcohol tests, pulmonary function studies for respirator compliance, and ██████████, a work injury prevention program.

██████████ is comprised of a certified rehabilitation registered nurse and a care coordinator. ██████████ is headed by a Medical Director and has a Medical Advisory Board made up of the Medical Director and four other physicians. ██████████ representatives of local businesses are on the Business Advisory Board.

██████████ has a contract with the Medical Director and agreements with ██████████ medical professionals as providers, and ██████████ employers.

You state that your members have provided healthcare for a local employer group of ██████████ employees. You have submitted ██████████ as an example of a contract under which your members

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provide such services. However, the contracting parties are  
██████████ and PHO.

██████████ is titled ██████████ Agreement. It is an agreement between ██████████, a ██████████ corporation and ██████████ (PHO) dated ██████████. The preamble states that ██████████ is organized for the purpose of coordinating the delivery of healthcare services and that it has and will enter into agreements with Plans (██████████) to assist such plans in arranging the delivery of healthcare services to members. It also states that PHO is a corporation which has contractual relationships with certain healthcare providers, including certain hospitals and physicians, whereby PHO is able to commit the services of those providers to provide care for members. The purpose of the Agreement is to secure the services of the healthcare providers, as selected by ██████████ in its sole discretion, for members.

Sections ██████████ and ██████████ of the Agreement provide for the necessary requirements of its primary care physicians and specialists such as licenses, insurance, and education and states that all services provided by physicians will be the sole professional responsibility of the physicians and that physicians must acknowledge that nothing in the agreement shall be deemed to constitute the practice of medicine by ██████████. Section ██████████ provides for obligations and responsibilities of PHO and its hospitals. ██████████ of the Agreement provides that the relationship between ██████████ and PHO is that of independent contractors. ██████████ the Agreement provides for payment for covered health services. It states that each participating Provider agrees to charge members no more than charges made to other private pay patients. It also provides the procedures for submitting claims.

With respect to contracts, you stated in your application that you would enter into and participate in third party payor arrangements pursuant to which your members would offer their services as health care providers. However, in your letter dated ██████████, you state that you hold no direct contracts with HMOs, PPOs, PHOs, insurers, or employers. You state that all contracts are held by PHO. You state that you are an "organization body" to allow physicians to participate with the hospital in these contracts. You submitted a sample contract as ██████████ which is a contract between ██████████ and PHO. See above.

You state that the only provider contracts that you have are the Participating Physician Agreements to be a part of PHO. You

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\_\_\_\_\_ have submitted \_\_\_\_\_ as a sample copy of a Participating Physician Agreement.

\_\_\_\_\_ is a sample Participating Physician Agreement between IPA and Physician. The preamble of the agreement provides that IPA intends, directly or indirectly to negotiate with and/or enter into contracts with alternative delivery systems products or other entities (individually, a "program" and collectively, the "programs") to provide or arrange for the delivery of health care services to members, insureds, or employees (the enrollees) of such programs in accordance with the terms of the agreement. It also provides that the physician anticipates that participation in IPA and in the programs with which IPA contracts according to the terms of this agreement may enhance physician's ability to provide health care services to his/her existing and/or new patients and to increase competition among programs entering the IPA's service area thereby reducing the cost of health services for employers and patients.

\_\_\_\_\_ of the Agreement provides for the physician participation in participating programs. It provides, in part, that physicians must participate in all Participating Risk Programs, which are defined as programs involving a "contract between a Program on behalf of its enrollees and the IPA on behalf of its physician members which describes the cost, procedures, benefits, conditions, limitations, exclusions and other obligations by which physician provides covered services to enrollees and which include: (1) a \_\_\_\_\_% or greater withhold; (2) capitated or percentage of premium payment arrangements; (3) the use of substantial penalties or rewards based on the overall costs or utilization by the physician; or (4) the use of \_\_\_\_\_ in which the IPA accepts a fixed fee per case for covered services; or (5) other risk payment methodologies as determined by the Department of Justice or IPA from time to time."

\_\_\_\_\_ provides for physician obligations such as membership requirements, licenses, insurance, services physician will provide, medical records, etc.

\_\_\_\_\_ provides for compensation and billing. It provides, in part, that physician shall be responsible for verifying enrollment and eligibility status of member with a participating program, for submitting claims to each participating program for covered services, and for billing and collecting for noncovered services, rendered to an enrollee.

\_\_\_\_\_ provides that the physician agrees to accept as full payment for covered services provided to enrollees of a

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██████████ participating program such amounts as are required to be accepted as such by the applicable participating program agreement.

██████████ provides that the physician is an independent contractor and not an employee, agent, or partner of IPA.

You indicated that clinical and operational educational offerings were one of the benefits you offer members. Upon our request to you to describe how these offerings are organized and conducted, you indicated in your letter dated ██████████, that you submitted an ██████████. However, there was no ██████████ to the letter.

Regarding the marketing of your services, you state that marketing contacts are made primarily through one-on-one encounters with local employers to offer assistance to them for their healthcare needs. You also state that you have also used occupational health staff in promoting other services provided through you.

In your letter dated ██████████ you state that you have no literature, newsletters, advertisements, brochures, or articles associated with your activities.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations defines "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will



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not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945), the Court stated that "the presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in Code section 501(c)(3) in its generally accepted legal sense. The promotion of health has long been recognized as a charitable purpose. See Restatement (Second) of Trusts, sections 368, 372; IV Scott on Trusts (3d Ed. 1967), section 368, 372; and Rev. Rul. 69-545, 1969-2 C.B. 117.

An organization that merely promotes health, without more, is not entitled to recognition of exemption under section 501(c)(3) of the Code. For example, while selling prescription pharmaceuticals promotes health, pharmacies cannot qualify for recognition of exemption under section 501(c)(3) on that basis alone. In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980), the Tax Court stated:

Virtually everything we buy has an effect, directly or indirectly, on our health. We do not believe that the law requires that any organization whose purpose is to benefit health, however, remotely, is automatically entitled, without more, to the desired exemption. 72 T.C. at 692.

Revenue Ruling 86-98, 1986-2 C.B. 74, describes an individual practice association (an "IPA") formed to provide health services through written agreements negotiated with health maintenance organizations ("HMOs").

The IPA's primary activities are to serve as a bargaining agent for its physician members in dealing with HMOs, and to perform the administrative claims services required by the agreements negotiated with the HMOs.

The main functions of the IPA are to provide an available pool of physicians who will abide by its fee schedule when rendering medical services to the subscribers of an HMO, and to provide the IPA's members with access to a large group of patients, the HMO subscribers, who generally may not be referred to nonmember-physicians. The IPA negotiates contracts on behalf

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of its members with various HMOs, administers the claims received from its members, and pays them according to its reimbursement agreement.

Revenue Ruling 86-98 states that these facts indicate that the IPA is akin to a billing and collection service and a collective bargaining representative negotiating on behalf of its member-physicians with HMOs. In addition, the IPA does not provide to HMO patients access to medical care which would not have been available but for the establishment of the IPA. Thus, the revenue ruling holds that the IPA operates in a manner similar to organizations carried on for profit, and its primary beneficiaries are its physician members rather than the community as a whole. Therefore, the IPA does not qualify for exemption from federal income tax as a social welfare organization under section 501(c)(4) of the Code.

You are essentially an independent practice association like the one described in Revenue Ruling 86-98, above. You are similar to the organization described in the revenue ruling in that you are controlled by your physician members, you provide no health care services, and you act as a bargaining agent for your physician members in negotiating managed care contracts with self-insured employers, HMOs, and other third party payors, thus providing your members with an expanded patient base. The direct benefits of your activities thus flow to private individuals engaged in the for profit practice of medicine rather than to the community as a whole.

Your Articles of Incorporation do not limit your purposes and powers to those described in section 501(c)(3) and do not contain a provision for the distribution of your assets upon dissolution which satisfies the requirements of section 1.501(c)(3)-1(b)(4) of the regulations. Therefore, you do not meet the organizational test described at section 1.501(c)(3)-1(b)(1) of the regulations.

Based on the facts above, you are not engaging in the practice of medicine or operating a hospital. You are merely negotiating managed care and physician care contracts for your physician members, which serves the private interests of the physicians rather than the interests of the community as a whole. You also work with local employers and other third party payors in developing health care delivery models which meet the private interests of such employers and third party payors rather than the needs of the community. Further, your physician members are "private individuals" as defined in section 1.501(a)-1(c) of the regulations. Your physician members receive prohibited private benefit which may include an advantage, profit, fruit, privilege,

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gain or interest. See Retired Teachers Legal Defense Fund v. Commissioner, 78 T.C. 280, 286 (1982). The substantial private benefit to your physician members is fatal to your exempt status. Also, physician members who serve on your governing board are "insiders" subject to the inurement proscription. Therefore, the same activities that constitute private benefit to your physician members result in prohibited inurement to those physician members who serve on your governing board.

Based on all the facts and circumstances, we conclude that you do not perform a charitable activity, you more than insubstantially benefit the private interests of your physician members and physician members serving on your governing board receive prohibited inurement.

You are neither organized nor operated exclusively for charitable purposes under sections 1.501(c)(3)-1(b) and 1.501(c)(3)-1(c)(1) of the regulations. You do not qualify for recognition of exemption from federal income tax under section 501(c)(3) of the Code and must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district

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office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
OP:E:EO:T:1, Room 6514  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

For your convenience, our FAX number is [REDACTED].

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

*Marvin Friedlander*

Marvin Friedlander  
Chief, Exempt Organizations  
Technical Branch 1

OP:E:EO:T:1

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6/11/99

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